Service Date: October 12, 1988

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER Of The Application Of The Application By The MONTANA POWER COMPANY For Authority To Increase Rates For Natural Gas Service.	UTILITY DIVISION DOCKET NO. 88.6.15 INTERIM ORDER NO. 5360a

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1. On June 30, 1988 the Montana Power Company (MPC) filed a request to increase natural gas rates. It proposes that rates be increased uniformly to all classes by 14.67%, or a total of $13,903,486. The application is caused primarily by return on investment for the North half of the new primary 16" transmission line and other associated facilities (about $3,800,000. in required revenues) as well as a higher requested rate of return (14% for equity, 11.89% for all investor-supplied capital, on average). The test year is 1987, modified for pro forma adjustments.

2. Concurrently, MPC requested that rates be increased temporarily by 7.49%, or $7,102,027. The interim increase was calculated using an overall rate of return of 10.5% and a weighted debt cost of 4.81%, which was agreed to by MPC in early 1988.

3. Through information requests, the Public Service Commission (PSC) has found certain costs it considers to be inappropriate for inclusion in temporary rates:

A. The ratio of Canadian gas from MPC's "Aden" fields should be maintained at the same purchase/royalty/fee proportion as was used in MPC's most recent gas cost tracker, which increases revenues required by $76,225.

B. A "benefit restoration plan" for 20 top executives and Board of Directors should be excluded, which decreases revenues required by $77,509.

C. Cost associated with long-lived computer programs (the Customer Information System and the Financial Management System) should be capitalized rather than being charged to expenses. This decreases revenues required by $138,136.

D. Construction by utility employees should reflect a full measure of the costs associated with using those employees, rather than outside contractors. For this interim, all fringe benefits associated with such labor will be capitalized, which decreases revenues required by $523,224. The question of whether "general office" construction supervision/support should be capitalized will be reserved for resolution at a later time.

E. Recorded exploration and development expenses will be used, rather than those projected. This decreases revenues required by $1,097,165. The PSC may use projected amounts in the final order, but only after fully exploring their intended uses.

3. Several MPC adjustments, which may or may not be controversial, have not been modified by the PSC. For example: The 5 year amortization of conservation expenditures ($46,109.); Dues to the American Gas Association ($56,435.); Pension expenses calculated on a "funding" basis, rather than according to Financial

Accounting Standards Board statement #87 ($67,974.); Distribution of "early retirement option" savings to construction, rather than immediately to gas ratepayers ($270,809.); Elimina tion of sales incentive program costs (-$93,812.); Allocation levels for natural gas administrative and general expenses to the Colstrip 4 division (-$11,971.); Certain insurance, injuries/damages and storm damages reserve adjustments (including deferred income tax effects); and, the provision of negative deferred income taxes for certain items as a result of the Tax Reform Act of 1986, rather than capitalizing those items for ratemaking. Parties are encouraged to address these issues, in addition to those adjustments made by the PSC in this order.

4. As previously discussed, the completion of the North half of MPC's new 16" pipeline is included in MPC's proposed rate base. The South half of the pipeline was found to be used and useful by PSC Order #5260, although rates were not adjusted at that time. Since the North and South halves are indistinguishable in their use at this time, it makes little sense to allow only the South half in MPC's rate base. Additionally, the PSC's pipeline safety inspectors found a marked improvement in procedures used in constructing the North half. These factors provide adequate justification to allow including the North half in rate base for interim purposes.

5. As an aside, the PSC notes that the pipeline and associated facilities will have increased MPC's rate base by about 26% (south half-$14,560,261+north half-$15,892,399+gas processing plant to meet pipeline specifications-$3,833,834+compatible pipeline from nearby storage facilities-$2,439,673+additional compression-

estimated at $8,000,000 divided by the most recent gas rate base without pipeline costs of $170,024,021). Aside from the issue of safety, the PSC is interested in cost savings and enhanced revenue producing capability resulting from this sizable investment. Included in such discussion should be potential uses for the old 20" pipeline. Since it is fully depreciated and is still being used, it may be unwise for the PSC to allow its retirement until such time as all potential uses for it have been explored and presented to the PSC.

6. The effect of the PSC's modifications to MPC's filing results in an interim revenue deficiency of $5,342,220. Accordingly, the PSC finds that rates should be increased uniformly by 5.6367%:

Gas Utility Rate Base	$215,052,226
Rate of Return	10.50%
Net Operating Income @10.5% Rate of Return	$22,580,484
Net Operating Income For The Year Ended 12/31/87 Adjusted for Known Changes	19,317,909
Required Incremental Increase in Net Operating Income	$3,262,575
Add: Corporate Environmental Tas	5,939
MPSC Tax	16,027
Consumer Counsel Tax	3,740
Income Taxes	2,053,939
Required Revenue Increase$5,342,220	
Corporate Environmental Tax (.12%)	5,939
MPSC Tax (.3%)	16,027
Consumer Counsel Tax (0.07%)	3,740
Taxable Income For State Income Tax	$5,316,514
State Income Tax (7.02%)	373,219
Taxable Income For Federal Income Tax	$4,943,295
Deferred Federal Income Tax- Montana Corporate License Tax	(126,894)
Federal Income-Current @34%	1,807,614
Required Incremental Increase in Net Operating Income	$3,262,575

CONCLUSIONS OF LAW

1. The Applicant, Montana Power Company, furnishes natural gas service to Montana consumers, and is a "public utility" under

the regulatory jurisdiction of the Montana Public Service Commission. Title 69, Chapter 3, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's Montana operations pursuant to Title 69, Chapter 3, MCA.

3. Section 69-3-304, MCA, provides in part . . . "The Commission may, in its discretion, temporarily approve increases or decreases pending a hearing or final decision."

4. The rate levels and spread approved herein are a reasonable means of providing this interim annual revenue increase for Montana Power Company.

5. The Commission finds that the Company's filing in this Docket, as modified by this Order, complies with the Commission's Interim rules. ARM 38.5.501 <u>et seq.</u>

<u>ORDER</u>

THEREFORE THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. Applicant, Montana Power company, is hereby ordered to implement on an interim basis rates designed to increase annual natural gas revenues by $5,342,220 on a uniform percentage basis.

2. Rate schedules shall comport with all Commission determinations set forth in this Interim Order.

3. Nothing in this Interim Order precludes the Commission from adopting in its Final Order, after reviewing the entire record in this Docket, a revenue requirement different from that contained in this Interim Order. Any refunds will be computed using MPC's most recently determined return on equity.

4. The interim annual revenue increase granted in this Interim Order is to be effective for natural gas service rendered on and after October 11, 1988.

DONE IN OPEN SESSION at Helena, Montana, this 11th day of October, 1988 by a 5 - 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

CLYDE JARVIS, Chairman

HOWARD L. ELLIS, Commissioner

TOM MONAHAN, Commissioner

DANNY OBERG, Commissioner

JOHN B. DRISCOLL, Commissioner

ATTEST:

Carol A. Frasier
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.